Proposals for Revision of the Loan and Trust Corporation Legislation and Administration in Ontario

November 1983

Ontario
Ministry of Consumer and Commercial Relations

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A. INTRODUCTION AND SUMMARY

1. HISTORY

Trust companies first commenced operations in Ontario in 1872 as the need for professional executors, long term estate managers, bond trustees, transfer agents, receivers and liquidators became apparent by reason of an increase in wealth and commerce in the province. The advantages of a well organized corporation with perpetual existence and having a capacity for diversified skills and adaptability to financing requirements became rapidly recognized. Loan corporations derive their origins from the early building societies and take deposits and issue debentures to the public. They have been regulated by the Loan and Trust Corporations Act since 1912. The original emphasis of the trust company in Ontario was as a provider of services rather than as a financial intermediary. Today trust companies, while retaining their original powers, have expanded so that they now also provide essential financial intermediary services to the public of Ontario. Those registered to do business in Ontario have received money from the public for deposit and guaranteed investment in excess of 34 billion dollars. Indeed, during the past ten years or so, the financial intermediary business of loan and trust corporations in Canada has grown even more quickly than that of the Canadian chartered banks. In addition, total estates, trusts and agencies under administration by trust companies in Canada exceed 65 billion dollars. The major importance of these companies in the Canadian financial system is undoubted.

As of November 1, 1983, 57 trust companies and 36 loan corporations were registered to do business in Ontario. Of these 20 are trust companies and 8 are loan corporations which are incorporated in and regulated by the province. A list of all registrants is attached as an appendix.

2. THE ECONOMIC BACKGROUND 1979–1982

The recent economic background in Canada is one of an economic malaise without precedent in the post-World War II era alongside unprecedented volatility in financial markets. With inflation, financial companies, such as loan and trust corporations, continued to experience rapid growth in nominal assets and often could show nominal gains in total net earnings. However, these developments tended in many cases to mask profit margin declines and deterioration of credit quality. Over a short period, interest rates rose dramatically with depositors expecting higher inflation and holding their funds in liquid, short-term assets. Also, the introduction of deposit insurance in the late sixties was a major factor in increasing the business and assets of loan and trust corporations of all sizes.

During the past three years particular difficulties were faced by those companies who specialized in long-term and fixed-rate mortgage financing. One result was that in a competitive environment with the chartered banks there was a loss to the industry in market share of residential mortgage loans as a percentage of the total residential mortgage market from 65 per cent in 1971 to 54 per cent in 1982. In addition, profit margins on existing fixed-rate mortgages were in many cases eroded because these assets were not correspondingly funded by term deposits and guaranteed investment certificates (GICs) of substantially identical interest rates and maturities. Accordingly, what is described as "mismatching" posed major problems for loan and trust corporations throughout this period. The result was that intermediation spreads between rates earned on investments and rates paid on deposits declined in some instances to negative spreads.

The loan and trust industry as a whole was absorbed with these problems as their importance and persistence became apparent. The overall industry response was good but a shift developed in mortgage lending toward shorter terms and the development of other types of lending based on floating rates rather than fixed rates. There was also a heavier reliance than previously on "basket clause" investments (which are investments that to a limited percentage of the corporation's assets can be made largely without regulatory controls). It may now be concluded that by and large the members of the Ontario industry are responding effectively to these competitive changes and to the distortions which economic and financial upheavals brought to their marketplace. This response process has already taken place to a large degree in most of the companies in the industry and should be fully accomplished in the next few years.

Loan and trust corporations were not alone in facing these problems. Credit unions have faced complete system restructuring which required legislative amendments to the Credit Unions and Caisses Populaires Act in Ontario on two occasions over the past two years. In addition, during the 1979–82 period insolvencies occurred in the automobile insurance industry. Ontario responded with amendments to the Motor Vehicle Accident Claims Act in an effort to provide some protection to the insured of defaulting companies through its Motor Vehicle Accident Claims Fund. The problems of banks in Canada and elsewhere, primarily with credit risks on existing major domestic and international loans, are well known and widely discussed.

Difficulties involving financial intermediaries are not unique to Ontario or Canada. Significant problems have been encountered by them in other jurisdictions; for example, in the United States there were 42 bank failures in 1982 and 43 bank failures in the first ten months of 1983. In addition, the Federal Savings and Loan Corporation, which regulates federally insured savings and loan associations in the United States, was involved in assisting 18 savings and loan corporations in the United States during the first seven months of 1983. The reasons for the significant number of failures in the United States are many and varied. They demonstrate that not only have financial intermediaries generally experienced difficult times in recent years, but also that the inflationary and volatile financial environment itself undoubtedly provided temptations and opportunities to abandon the level of prudent behaviour required of fiduciaries.

3. THE REGULATORY MODE

In 1964 the Porter Royal Commission on Banking noted that *"regulation cannot guarantee that there will never be incompetent, negligent or even dishonest management in the financial system unless every transaction were to be investigated ahead of time and economic life brought to a complete halt."*

The practical reality that some corporations will fail with shareholders suffering losses, as in any commercial venture, will always remain. The primary regulatory objective must be to ensure that depositors and customers not suffer loss and to achieve this result in a manner that enables companies to compete successfully in the marketplace in the provision of needed financial services to individuals and businesses.

In 1968 the Canada Deposit Insurance Corporation (CDIC) was established providing $20,000 insurance for all deposits with approved financial institutions thereby enabling loan and trust corporations to acquire public money with greater ease.

The 1969 report of the Royal Commission appointed to enquire into the failure of Atlantic Acceptance Corporation Limited addressed many aspects of the regulation of loan and trust corporations. Despite the activities which ultimately led to the collapse of Atlantic Acceptance and the difficulties of British Mortgage and Trust, the report of the Royal Commission

indicated a continuing confidence in the high degree of responsibility and capacity for self-regulation in the loan and trust industry. With respect to the regulation of the industry the Royal Commission commented as follows:

> *"The expression 'gentleman's agreement' has been used by former Registrars to describe their understandings with the heads of companies in the implementation of policy, or varying a strict interpretation of provisions of the Act. There is no reason to change the spirit of this relationship because of a few exceptional cases, one of which has been the subject of close examination by this Commission. It is unlikely that long-established companies, standing for prudence and reliability in the world of finance, will jeopardize their reputations, if their legitimate aims are supported by knowledgeable and flexible government regulation, designed at once to encourage the industry and protect the public. I say with deliberation, after long contemplation of the sorry performance of Atlantic Acceptance Corporation and British Mortgage & Trust Company, that it is unwise and shortsighted to construct legislation based upon experience with one or two backsliders, and with a view to protecting the public from what really amounts to a breach of faith, or of the law, which prescribed sanctions, if resolutely applied, are able to deter or punish."*

In the interval following the 1969 Report the legislation and the practices of the Registrar and his staff continued to rely significantly on the integrity of company officials and their professional advisors. When a company was found to be in financial or administrative difficulty it was the usual practice to negotiate the procedures by which the company would correct its deficiencies.

This approach was also followed by the Canada Deposit Insurance Corporation, which still operates largely on the basis of non-legislative guidelines, and by the federal Superintendent of Insurance whose legislative powers and administrative practices of intervention prior to December 1982 were little different from those of the Registrar in Ontario.

Some change in process was initiated in Ontario in recent years when more emphasis was placed on the use of investigators in addition to examination staff. However, the inflationary environment made it easier for less than scrupulous operators to put a plausible face on transactions which provided benefits for themselves while placing depositors, shareholders and others at substantial financial risk.

It was against this general background that the Registrar addressed the events leading up to the taking of possession and control of the assets of the trust companies. Experience has shown that the then existing legislation and practices could not effectively deal with those events. One consequence was that, as a first step, the Ontario Legislature on December 21, 1982 took the unusual step of passing in one day Bill 212, an Act to Amend the Loan and Trust Corporations Act. The Bill had the following purposes:

1. to control changes of ownership of Ontario loan and trust corporations;
2. to permit the imposing of terms and conditions on the registration of any registered loan and trust corporations;
3. to provide the Cabinet with authority to pass an order-in-council for the timely and efficient taking of possession and control of the assets of Ontario loan and trust corporations where, among other things, depositors were being jeopardized;
4. to provide a procedure whereby the Registrar could enquire into the beneficial ownership of shares of Ontario loan and trust corporations; and
5. to provide for court orders of compliance against violators of the provisions of the Act.

One effect of the enactment of this Bill was to change the emphasis in the Loan and Trust Corporations Act from that of a code of good conduct for registrants to a stricter regulatory statute. Many former infractions became "offences" punishable by the

Court and subject to enforcement orders by the Court.

One result of taking possession and control of the assets of Crown Trust Company, Seaway Trust Company and Greymac Trust Company by the Registrar pursuant to orders-in-council under the new provisions, which took place at the beginning of 1983, was that it revealed certain undesirable activities where investment practices had placed depositors at serious risk. At the same time and as a result of their own investigations the federal authorities took control of the assets of Seaway Mortgage Corporation and Greymac Mortgage Corporation. Those investigations revealed that the depositors of those companies were also at risk.

In June 1983, Mr. James A. Morrison, who had been appointed the previous November, completed his special examination of the three trust companies and the two mortgage corporations. As a special fact finder with the benefit of certain of the powers under the Public Inquiries Act, he explored behind the documentary records of the companies into the true nature of the arrangements between and conduct of the principals of the companies, the directors and officers and their professional advisors. Investigations and reports were made by The Clarkson Company Limited and by Touche Ross Limited during the early part of 1983. These reports also found inappropriate and imprudent activities on the part of the trust companies and failures of responsibility by individuals and firms associated with carrying out those activities. These findings were important to the preparation of this paper.

It is obvious that the so-called "gentleman's agreement" approach to regulation, which depended on a common sense approach to regulation on the part of the authorities and the reliability and integrity of those in charge of the companies, could no longer be counted upon to be effective. Abuses and inappropriate practices evidenced in the activities of these and other loan and trust corporations necessitate specific proposals for revision to the Loan and Trust Corporations Act to ensure that the public confidence in the loan and trust industry continues to be justified.

4. OTHER BACKGROUND

The federal Department of Insurance in its recent proposals respecting the Trust Companies Act (Canada) and the Loan Companies Act (Canada) recommended a substantial and virtually total restructuring of the operations and regulation of federally incorporated trust companies and loan companies. The basic issues underlying the federal proposals have been examined from the point of view of the Ontario perspective and in the light of subsequent events. They have been helpful in indentifying the matters to be considered and taken into account in making both administrative and legislative changes. Certain of those issues are the subject of specific recommendations which form a part of this paper. However, the federal proposal calling for a total restructuring of the loan and trust industry has not been adopted, as it is not considered necessary or appropriate in order to achieve the objectives of a sound loan and trust industry in Ontario.

The 1975 Report of the Select Committee on Company Law on Loan and Trust Corporations was also a valuable source of views and recommendations in the preparation of this paper and will be of particular importance in the preparation of legislation following consideration of this paper. That report was prepared before the onset of the unique economic and financial conditions of the 1979–82 period. It was thus not responsive to the problems which emerged during that period nor to the abuses which were discovered and which require significant changes in legislation and administration.

5. OBJECTIVES AND APPROACH

The proposals advanced in this paper for discussion and consideration by the

public, the industry and members of the Legislature are designed to contribute to the achievement of several objectives:

1. To maintain and enhance public confidence in financial institutions in Ontario and thereby contribute to the high and deserved level of confidence which persons inside and outside Canada traditionally place in the Canadian financial system.

2. To establish a regulatory and administrative system that will be a more effective counter-force to those who would abuse or violate the legislation under which they operate or who would jeopardize depositors and others with legitimate interests by their conduct.

3. To provide a better and clearer code of conduct and accountability for directors, officers and advisors of registrants in order to achieve a better and more responsible form of self-government within the corporate framework of all registrants.

4. To provide at the same time a regulatory framework that is flexible enough to ensure effective freedom of action in the marketplace to those registrants who do conduct their business in a sound financial manner and in the public interest.

The proposed new regulatory framework and administrative arrangements proposed in this paper are designed to advance the above objectives. They reflect the conclusion that the changes in the economic and financial environment of the past few years and the recent experiences with certain loan and trust corporations, such as those described in the Morrison and other reports dealing with the three Ontario trust companies and two federal mortgage companies previously discussed, dictate a substantial overhaul of important parts of the legislation and administration covering loan and trust corporations in Ontario. At the same time, while the proposals represent a substantial overhaul in the legislation and administration affecting loan and trust corporations in Ontario, by far the vast majority of these corporations have coped positively and prudently with the much tougher economic and financial environment prevailing during the last two or three years. This means that needed changes should not and need not add materially to their burdens or restrict them in their continued ability to respond efficiently and competitively to customer demands in the marketplace. Indeed, those who have the financial strength and demonstrate the intention and ability to meet their fiduciary obligations will be able to take advantage of an enlarged ability to make commercial loans.

There are five principal dimensions to the thrust of the proposals contained in this paper:

- The new uncertain and volatile economic and financial conditions mean that even the best intentioned and competent management can run into difficulties with matching their cost of funds borrowed from the public by deposits and guaranteed investment certificates to their corresponding return on funds loaned on mortgages and other security and with the credit quality of such loans. This means that timely and relevant information and the means of taking prompt corrective action is essential to effective government regulation in this environment.

- Most loan and trust corporations recognize fully the fiduciary obligations imposed by their privileged status as financial institutions which are entitled to seek deposits from the public and have those deposits insured up to the new limit of $60,000 at the expense of all banking and loan and trust corporations. However, the few which do not can create a threat to their own public depositors and to the Canadian industry and financial system as a whole out of all proportion to their size and number. This means that an effective control regime is required that combines a number of elements which together reduce the risk of abuse and increase the ability of the regulatory authorities to respond quickly and

effectively where a risk of abuse occurs.

- As the purpose of the industry is to serve the public by providing competitively priced financial services in response to customer needs and demands, it is important that requirements to protect the system and public depositors from abuse not interfere with the ability of the responsible members of the industry to carry on their business. This means that new laws and administration must, to the maximum extent practicable, not increase the burdens or restrictions on those in the industry who are conducting their business with prudence and are behaving in full recognition of their legal and fiduciary obligations.

- There is no one answer to the risk of abuse in loan and trust company regulation any more than in any other area. Imprudent lending by managers not effectively accountable can represent as great a threat to depositors, and thereby reduce confidence in the financial system, as can those who deliberately abuse their trust and fiduciary responsibilities. This means that a multiple approach to control of abuse and the monitoring of the normal corporation under present conditions is likely to prove a more appropriate approach than one based on any single control mechanism. While a single control mechanism may appear to be applicable in some cases of abuse, it is equally likely to prove inapplicable to others and may well adversely affect responsible corporations who are conducting their operations properly and prudently with due regard to their fiduciary obligation to the public who entrust their funds to them.

- Confidence in the financial system, and the loan and trust industry part of it, is indivisible. This means that it is essential that the practical cooperation achieved between federal and provincial authorities in the difficult situations encountered during the past year have a firm basis in federal and provincial law and administration. It also means that the Ontario public must be entitled to assume that all loan and trust corporations doing business within Ontario are subject to essentially the same legal and administrative standards.

These have resulted in proposals which reflect the following approach:

1. There is no demonstrated need and it would be unfair and costly to force a radical restructuring of the industry because of recent abuses. This paper recognizes the importance of controlling shareholdings. It recommends controls and safeguards to protect the public primarily by a review of their acceptability as incorporators or transferees of shares. The government is not disposed to introduce a rigid maximum limit to shareholdings regardless of the particular circumstances.

2. There is a need to clarify and toughen the conflict of interest rules and the standards of those professionals involved in transactions where conflicts of interest may have an improper influence. There is also a need to impose obligations and penalties for their breach which act as a strong deterrent against engaging or assisting in questionable transactions.

3. There is a need for a somewhat more active regulatory effort than served the public well under quieter times. At the same time it is essential to ensure this effort reflects good business sense as well as an alertness to possible abuse. The alternative would be a much more legalistic and restrictive regulatory regime which would weaken the loan and trust industry and make it much more difficult to do legitimate business and meet customer needs efficiently, while not being able to guarantee against abuse through unavoidable legal loopholes.

4. There is a need to restructure the regulatory administration of

financial institutions generally, and of loan and trust corporations in particular, to achieve a more effective and responsive regulatory effort. This requires a more public and somewhat more independent office, although ultimately accountable to a Minister and the Cabinet, or to the courts, as the case may be, whose holder would exercise important new responsibilities in relation to financial institutions. It also requires separating and treating as of at least equal importance the ongoing investigative effort into possible abuse and the normal financial examination of companies who are operating with due regard to their fiduciary obligations. A quite different approach is needed for each of these two classes of activities. This can only be satisfactorily achieved if there is a separate investigatory unit which must cooperate with a financial examination unit, both under the direction of a senior official within the Ministry of Consumer and Commercial Relations with overall responsibility for financial institutions.

5. It has always been recognized that there are different financial strengths and capabilities among loan and trust corporations. The clearest example is the difference in multiples of borrowing base permitted between different companies. This concept is sound but recent events indicate a need to broaden its application as part of a more appropriate and effective regulatory effort. This would involve discretion to increase the borrowing multiple, to expand the power of a loan corporation to include trust powers and to increase the commercial lending power and the freedom to establish branches based on growing financial strength, proper experience and capability and a track record of regulatory compliance.

6. A balance is required between restricting some companies primarily to a deposit-taking and mortgage-lending operation, which may be appropriate in many cases, and extending the power to other companies to include specific fiduciary powers and broaden the commercial lending power beyond what is now possible under the so-called 'basket clause'. It appears appropriate at this time to provide a specific but narrowly limited commercial lending power to the strongest and most experienced trust companies. This should and can be done in a manner which does not change the essential character of their business or open the door to unacceptable conflicts of interests. At the same time, it can increase financial alternatives available to customers of trust companies who would like to be able to do this as well as other business with those companies.

The focus of this paper is on changes in the law and administration designed to improve the ability of the government regulators to discharge their responsibilities in relation to loan and trust corporations and to establish clear rules for shareholders, affiliates, directors, officers and professional advisors to loan and trust corporations to follow in their dealings with loan and trust corporations. This does not, however, alter the fact that there is a necessity for members of the public in general, and for members of the financial community in particular, to accept a measure of responsibility to behave prudently in their dealings with loan and trust corporations. There is no question well-conceived laws and effective government regulations are essential to ensuring a loan and trust industry which merits public confidence. But laws and regulations, however good, are not enough in themselves to justify confidence. This must be earned every day by the responsible and intelligent behaviour of the industry itself and those who advise it or act on its behalf.

Depositors in the Ontario regulated companies which ran into difficulties during the past year have been repaid in full, whether or not their deposits were within the insured limits. This was

because the action taken by the Ontario government enabled Canada Deposit Insurance Corporation to conclude that losses would be less by paying off all arm's length depositors, insured and uninsured alike, when due, and keeping the business going to the maximum extent, than would have been the case if the alternative of the companies going into liquidation had occurred. Prudent depositors in any Canadian financial institution should not assume that these circumstances will automatically occur again. They should exercise their own judgment in determining how much they should place in a particular financial institution.

6. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

The following is a summary of the conclusions and recommendations contained in this paper:

ADMINISTRATION (pages 13 to 15)

1. In the future, there should be a more active approach to regulating loan and trust corporations in Ontario in order to anticipate problems.

2. It is proposed that a new position of Commissioner of Financial Institutions be created, reporting directly to the Minister, to be filled by a senior person from the professional community with a primary responsibility to:

   a) provide general and specific policy advice to the Minister on matters affecting provincially regulated financial institutions, including loan and trust corporations, insurance companies and credit unions;

   b) act as watch dog for the public interest by maintaining close contact with public concerns and having the power to hold hearings and review issues affecting the loan and trust industry; and

   c) hear appeals from decisions of the Registrar.

3. An independent Financial Advisory Committee is also proposed consisting of experienced persons in the financial and business community which would serve as advisor to the Commissioner, with the capability of assisting in the appellate functions.

4. The present position of Executive Director of Financial Institutions should be replaced by an Assistant Deputy Minister with responsibility for the administration of all branches within the ministry regulating financial institutions in Ontario.

5. The Registrar of loan and trust corporations should be given much broader and more far-reaching regulatory powers.

6. The position of Assistant Deputy Minister should be separated from the positions of Registrar of loan and trust corporations and Superintendent of Insurance.

7. A separate investigative unit reporting directly to the Assistant Deputy Minister should be established with special capability to investigate irregularities and problems in all financial institutions regulated within the ministry.

CARRYING ON BUSINESS IN ONTARIO (pages 16 to 21)

1. All loan and trust corporations carrying on business in Ontario, wherever incorporated, should be subject to essentially the same rules, standards and criteria.

2. The granting of letters patent incorporating a loan or trust corporation should remain discretionary, but the criteria to be satisfied by applicants for incorporation should be stricter and more clearly defined.

3. Corporations starting a business in Ontario should begin with the minimum powers of a loan corporation and should be entitled

to apply for additional powers as they demonstrate their commitment and capability to fulfill them. The estate, trust and agency powers of a full service trust company should only be granted to those corporations with demonstrated capability in those areas and the necessary financial resources and other qualifications.

4. The minimum capital for the incorporation of a loan corporation should be increased to $2 million and the minimum capital for a full service trust company should be $10 million. Existing corporations which do not meet the financial criteria would be given time to do so.

5. The powers and functions of every loan or trust corporation carrying on business in Ontario should be reviewed annually.

6. Persons proposing to acquire or merge with an existing loan or trust corporation in Ontario should satisfy the same standards and requirements as those who incorporate a new corporation.

7. The Registrar should be given the power to require subsidiaries of loan and trust corporations to cease unacceptable business or financial practices.

8. The maximum investment by a loan or trust corporation in another corporation, other than a subsidiary, should be reduced from 20 per cent to 10 per cent, making it less likely that a number of corporations, acting secretly and in concert, can avoid the provisions of the Act.

9. The Registrar should have the power to designate corporations in which a loan or trust corporation has invested as an affiliate, with special rules applicable to all transactions with such affiliates.

10. The power of the Registrar to regulate and control transactions between a loan and trust corporation and its holding company should be increased and more closely controlled.

11. New restrictions should be introduced affecting the issuance of shares of a loan or trust corporation for other than cash and the consideration that may be received for such shares.

12. The Registrar should have authority to require specific transactions to be submitted to the board of directors of a loan or trust corporation or to require the loan or trust corporation to make the transaction public.

13. All loan and trust corporations carrying on business in Ontario would register initially and renew their registration annually. No registration should be granted or renewed unless the corporation is a member in good standing of the Canada Deposit Insurance Corporation.

14. Borrowing and investment powers should be controlled by the Registrar at the time of registration and annual renewal, with increased borrowing capability and investment powers being dependent upon demonstrated capability and resources.

15. Loan and trust corporations incorporated outside the province but carrying on business within the province should be closely regulated in the same manner as Ontario loan and trust corporations. The Registrar should have the power to impose limitations on their registry and the power to control their activities according to rules based on competence, responsibility and fitness.

16. The Registrar should have the power to require corporations to take remedial action where required, including the power to require increases in capital, cessation of investments and reduction in borrowing capacity.

LIMITATIONS ON OWNERSHIP
(pages 22 to 25)

1. The present provisions of the Act introduced in 1982 requiring the consent of the Registrar for the transfer of shares of Ontario loan and trust corporations, and their holding corporations, where the acquirer owns or controls 10 per cent or more of any class of shares, should be extended to apply to all loan and trust corporations carrying on business in Ontario. The Registrar should be given the power to cancel or modify the registration to do business in the event any transfer is made affecting such a corporation contrary to the provisions of the Act, or where the Registrar is denied information from any such corporation respecting beneficial ownership.

2. The criteria for the Registrar giving or withholding his consent to transfer shares should be based on those criteria applicable to the incorporation of a loan or trust corporation in Ontario

3. An appeal to the Lieutenant Governor in Council from the Registrar's decision should continue, but an intermediate appeal to the Commissioner of Financial Institutions would be introduced.

4. No absolute limitation on the ownership of the shares of a loan or trust corporation operating in Ontario is proposed at present, although such a limitation was seriously examined, and some discretion in this respect may be desirable.

5. The possibility of a majority shareholder putting personal interests ahead of fiduciary responsibilities can probably be more effectively dealt with by specific conflicts of interest amendments rather than by absolute limitations of ownership.

6. The emphasis on greater monitoring of the decision-making process by boards of directors, auditors, management and others, which involves more self-policing, would seem to be a better way of preventing conflict of interest abuses.

CONFLICTS OF INTEREST
(pages 26 to 27)

1. To prevent the reoccurrence of recently discovered abuses, a multi-faceted approach is proposed involving not only a more active and stringent regulatory process but also increased self-policing, sounder and more prudent business practices and an increased awareness of their respective responsibilities by directors, managers, lawyers, auditors, valuators and other advisors.

2. Internal review procedures of registered corporations should be strengthened and tightened.

3. External advisors should be made legally accountable.

4. Professional associations should be expected to redefine codes of conduct and ethics.

5. Auditors should be given rights to call and attend audit committee meetings.

6. Auditors should be expected to advise the board of directors and the Registrar of breaches of conflicts of interest rules that come to their attention.

7. Registered mortgage brokers and their officers should be ineligible to serve as directors of loan and trust corporations.

8. Corporations should be prohibited from purchasing or acquiring goods or management services or paying finders' fees to any affiliated corporation or holding corporation, except with the prior approval of the Registrar.

9. A reviewable and voidable transaction concept should be introduced so that improvident transactions between corporations and insiders, or affiliates, can be set aside and money or assets recovered.

10. The Registrar should be given wide authority to require changes in internal approval processes and procedures of regulated corporations.

BUSINESS AND POWERS (pages 28 to 30)

1. Corporations should be obliged to make clear to their depositors the extent to which their monies are insured with the Canada Deposit Insurance Corporation.

2. Funds held in trust should be segregated from a corporation's funds and shown separately in financial reports.

3. A prudent lender's standard should be introduced for mortgage lending and valuation purposes for all real estate lending.

4. Third and subsequent mortgages should be limited as investments for all loan and trust corporations.

5. The Registrar should be entitled to require corporations to establish appraisal standards and define the circumstances under which independent appraisals are required for real property.

6. Loan and trust corporations should not be permitted to own directly or indirectly real property having an aggregate value in excess of 10 per cent of the book value of the assets of the corporation.

7. Loan and trust corporations should be entitled to engage in commercial lending up to a maximum of 15 per cent of the assets of the corporation with specific limits on loans to any one borrower or related group. Corporations engaging in commercial lending should segregate their commercial lending activities from their fiduciary functions.

8. No corporation should be permitted to carry on any estate, trust or agency activity in Ontario until it has satisfied the Registrar that it has the commitment, organization and resources to do so on a long-term basis.

MANAGEMENT AND ORGANIZATION (page 31)

1. Corporations should notify the Registrar following the election, removal or resignation of any director and prior notification and approval from the Registrar would be required before the appointment of the chief executive officer or chief financial officer of every registered loan and trust corporation.

2. An audit committee should be mandatory for all loan and trust corporations consisting of a majority of outside directors who are not officers or employees of the corporation.

3. An investment committee consisting of a majority of outside directors of the corporation should be appointed to assure appropriate standards and levels of authority for all loans and investments made by the corporation.

4. The board of directors should be required to review specific financial data regularly to assist early detection of problems.

FINANCIAL STANDARDS AND CONTROLS (page 32)

1. The Registrar should be given authority to control borrowing from the public by determining the assets to be included in the borrowing base and the authorized borrowing multiple. Borrowing multiples should vary with proven experience and resources from a minimum of 10 times the borrowing base to a maximum of 25 times.

2. The Registrar should be entitled to prescribe maximum borrowing costs and commissions payable by a corporation from time to time in the light of prevailing market conditions.

3. Standards for matching of interest and terms of borrowing and lending should be established, with the Registrar given broad authority to require corrective action where mismatching occurs.

FINANCIAL RECORDS AND REPORTS (pages 33 to 34)

1. A major restructuring of the reporting process is proposed for all loan and trust corporations. An experimental reporting system now being tested will be introduced and expanded in 1984 for all loan and trust corporations operating in Ontario. The system would show exceptions and infractions and provide an early warning signal for potential problems. It should be accompanied by audits and investigations specifically directed to problem areas.

2. All loan and trust corporations should standardize their record keeping and reporting.

ENFORCEMENT (pages 35 to 36)

New safeguards and remedial actions are proposed where the additional self-policing responsibilities are not adequate to protect the public interest, including in particular:

- the investigative capability of the ministry respecting financial institutions should be substantially strengthened;
- a rehabilitation capability should be created for monitoring and enforcing a course of action directed by the Registrar with a view to restoring a corporation to full compliance with the Act and regulations, all designed to achieve rehabilitation without the Registrar taking physical possession; and
- where rehabilitation is not possible for any reason and taking possession is necessary, the Registrar's authority should be strengthened and his options increased.

HEARINGS AND APPEALS (pages 37 to 38)

1. An expedited hearing and appeals procedure is proposed under which the Registrar should be entitled to direct corporations to take or refrain from taking specific action and the corporation would be bound by that direction during the appeal process, so that depositors' money and the public interest would be protected until the potentially lengthy appeal process has run its course.

2. Appeals on errors of law or fact from decisions of the Registrar would be provided to the courts and an additional appeal on matters of significant business import would be available to the Commissioner.

3. Where the Registrar has been obliged to take possession of a loan or trust corporation and rehabilitation is not possible, then the courts would be given a new and significant role in determining the terms and conditions under which the Registrar would remain in possession or the assets and undertaking would be sold.

B. ADMINISTRATION

1. NEW REGULATORY DIRECTION

For the reasons mentioned it is clear that a more active approach to regulation is required for loan and trust corporations in the future than was necessary in the past. This will involve not only changes in legislation but also significant modification of the administrative process. Specifically the following new elements are proposed:

- A new office, the Commissioner of Financial Institutions, should be created accountable directly to the Minister of Consumer and Commercial Relations. The office would combine advisory, policy and appellate functions with monitoring and evaluating roles responsive to industry needs and public concerns.
- A Financial Advisory Committee comprising professionals from the legal and financial community should be established to assist the Commissioner in the performance of various functions and to ensure that the Commissioner and the Minister receive the benefit of the best practical advice from those experienced in matters affecting not only the loan and trust industry, but all financial institutions in Ontario.
- The creation of a new Assistant Deputy Minister position to whom the Registrar of loan and trust corporations would report. The Assistant Deputy Minister would be given the responsibility of implementing, through various branches, policy initiatives affecting loan and trust corporations and other financial institutions, including those proposed in this paper and those initiated from time to time by the Commissioner of Financial Institutions. The Assistant Deputy Minister would act as senior administrative officer under the Deputy Minister for all branches involved in the regulation of financial institutions within the Ministry of Consumer and Commercial Relations.
- A clear separation should be made between the function of the financial examination of those corporations which are competent and responsible in the conduct of their business and the function of the investigation of those individuals and corporations showing signs of not adhering to the standards of prudence and trust required.

2. COMMISSIONER OF FINANCIAL INSTITUTIONS

It is proposed that there be established within the Ministry of Consumer and Commercial Relations a new and senior office to be known as the Commissioner of Financial Institutions reporting directly to the Minister. The Commissioner should be a senior, respected person in the financial, legal or accounting community appointed for a fixed period by order-in-council. The Commissioner's responsibility would be broad and far-reaching with respect to loan and trust corporations, insurance companies, credit unions and other financial institutions regulated within the Ministry of Consumer and Commercial Relations. With respect to loan and trust corporations specifically, the responsibilities of this position should include at least the following:

- To develop and recommend to the Minister policy initiatives and changes as may be appropriate for the advancement of the public interest, the protection of depositors and others and for the maintenance of public confidence in the industry. Advice and recommendations should take into account the views of the Financial Advisory Committee and those of the industry and the members of the public, with whom the Commissioner should maintain close contact.

- Act as chairman of the Financial Advisory Committee and, as such, have authority to hold public and other hearings to deal with issues which have been specifically referred by the Minister or which, on the Commissioner's own initiative or in response to public concern, can be more effectively examined and assessed by such means.
- Hear appeals from the decisions of the Registrar, either alone or in conjunction with members of the Financial Advisory Committee. Such appeals would be in relation to designated matters primarily involving business or financial issues rather than appeals of law or fact more appropriately heard in a court of law.
- Act as senior policy advisor to the Minister generally on all issues respecting the loan and trust industry, primarily on the Commissioner's own initiative but also on specific issues referred by the Minister.
- Advise the Minister from time to time on the overall effectiveness of the regulatory process administered by the ministry.
- Acting alone or in conjunction with other members of the Financial Advisory Committee, the Commissioner could be authorized by the Minister to hold inquiries with all the necessary powers of a commission under the Public Inquiries Act.
- The Commissioner would be in a position to undertake comprehensive and regular reviews of the adequacy of legislation administered by the Financial Institutions Division of the ministry.

The Commissioner would exercise comparable functions with respect to other financial institutions regulated within the ministry, and would, therefore, be one of the most important resources for the Minister on all matters pertaining to financial institutions within the regulatory responsibility of the ministry. The Commissioner would have the independence and authority to bring matters of importance to the attention of the Minister as may be required by the public interest. Nevertheless, the responsibility for approving all policy and other changes would remain that of the Minister and the actual process of implementation should be the responsibility of the Assistant Deputy Minister acting under and reporting to the Deputy Minister.

3. THE FINANCIAL ADVISORY COMMITTEE

To assist the Commissioner, an independent advisory committee would be established comprising professionals from the legal and financial community appointed by order-in-council from time to time. Because the Commissioner would be in a position to exercise a major influence on the regulatory environment of loan and trust corporations in Ontario it is important that the Commissioner command and justify the confidence of both the industry and the public. The Financial Advisory Committee would have an essential role in this regard through its independence and the experience and credibility of its members. In addition, its members would be available to participate in the discharge of the appellate responsibilities of the Commissioner and would also be in a position to exercise the functions of a commission under the Public Inquiries Act.

4. ASSISTANT DEPUTY MINISTER AND REGISTRAR

In considering ways in which the administration of loan and trust corporations could be improved, the responsibilities of the present office of Executive Director of Financial Institutions were reviewed. Under the existing organization of the Ministry of Consumer and Commercial Relations, the Executive Director of Financial Institutions is also the Superintendent of Insurance and the Registrar of loan and trust corporations. Although this concentration of positions and related

responsibilities appears to have worked satisfactorily in previous years, this is no longer the case.

Accordingly, it is proposed that the present position of Executive Director of Financial Institutions should be replaced by an Assistant Deputy Minister to whom all the branches responsible for the regulation of financial institutions would report, including the Registrar of loan and trust corporations and the Superintendent of Insurance. The basic function of the Registrar in overseeing the day-to-day operations of loan and trust corporations should remain the same. However, the Registrar would also assume the additional responsibilities inherent in the implementation of the recommendations in this paper. It is proposed that the decisions of the Registrar be subject to review in respect of errors of fact or law by the courts in the usual way. In addition, decisions of the Registrar which could have significant adverse effects on the business of a loan or trust corporation will be subject to an appeal to the Commissioner of Financial Institutions.

5. INVESTIGATIONS

As part of a reorganization of the financial institutions division the role of the investigative staff should be augmented. It is proposed that a separate investigative unit be established reporting to the new Assistant Deputy Minister position. It would be charged with the responsibility of monitoring all financial institutions regulated within the ministry. The investigative capability would include in-depth investigations of irregular situations. The operation of a coordinated and centralized investigation unit would increase the possibility that questionable persons or practices within different types of financial institutions will be detected in a timely manner. It should also be organized to facilitate prompt and direct responses to those individuals and corporations which show any signs of departing from the Act or their fiduciary responsibility of prudence and good faith in dealing with the public's funds.

C. CARRYING ON BUSINESS IN ONTARIO

1. GENERAL

It is a privilege, not a right, to carry on the business of a loan or trust corporation in Ontario. It is proposed that the Loan and Trust Corporation Act make it clear that this is equally true for the incorporation of a new corporation, the acquisition of or merger with an existing corporation and the registration to do business of every corporation. Further, the Act should provide that the same criteria be applied to all corporations in determining their fitness to commence a loan or trust business in Ontario, the standards they must observe to remain in business and the circumstances under which the privilege to continue in business should be curtailed or withdrawn.

2. INCORPORATION

Loan and trust corporations are incorporated by letters patent. These are issued in the discretion of the Lieutenant Governor in Council upon the petition of at least five applicants through the Ministry of Consumer and Commercial Relations, after obtaining the approval of the Registrar and satisfying requirements respecting minimum capitalization and fitness and demonstrating public convenience and necessity in the location of the proposed head office.

It is proposed that the issuance of letters patent remain discretionary. However, the criteria to be satisfied by the applicants should be stricter to assure that only persons with high standards and integrity are given the powers and responsibilities involved.

Under the present Act, loan corporations can apply for certain fiduciary powers and, depending upon their experience and resources, such powers are granted or refused in the discretion of the Lieutenant Governor in Council. In order to assure that the powers of a corporation are matched by its capabilities and resources, it is proposed that initially each corporation will start in business with the minimum powers of a loan corporation. As it demonstrates its capability to handle broader powers, it may apply for and be granted them. Ultimately, with proven experience and capability, the corporation could become eligible to apply for the fiduciary and other powers of a trust company.

The criteria for a corporation to obtain additional powers should be clearly defined. It is proposed that the Registrar have the responsibility, subject to appeal to the Commissioner of Financial Institutions, to decide whether to recommend passing the requisite order-in-council and whether a particular corporation has satisfied such criteria. The decision of the Commissioner not to recommend the granting of additional powers would be final in the absence of an error in fact or law. Further, supplementary letters patent would be required for a corporation to expand its powers and functions. The present position that the Lieutenant Governor in Council makes the final decision would be preserved. However, that decision would only be made in the light of the recommendation of the Registrar and, where applicable, the Commissioner.

The minimum capital requirement is presently $1,000,000 for the incorporation of a loan or trust corporation. It is proposed to increase that minimum to $2,000,000 to reflect current economic conditions. Each corporation should be required to increase its capital on a graduated scale as its powers are increased and as physical locations expand, all according to standards and criteria to be established and published by the Registrar from time to time. The minimum capital for a trust company operation offering a full range of services should be increased to $10,000,000, with authority in the Registrar to recommend approval of a lesser minimum capital in special circumstances. Existing corporations that do not satisfy the prescribed minimum capital standards should be

entitled to phase in capital increases according to their circumstances and on a basis approved by the Registrar. Decisions of the Registrar respecting capitalization should be subject to appeal to the Commissioner, although the final responsibility for confirming bylaws changing the capital should continue to rest with the Lieutenant Governor in Council. Later in this paper it will be explained how corporations may expand the scope of their operations, increase their borrowing and deposit-taking capabilities and broaden their investment and lending powers to reflect their capital base and other relevant factors.

3. PUBLIC CONVENIENCE AND OTHER STANDARDS

Applicants for incorporation must presently satisfy the Registrar and the Lieutenant Governor in Council that in the locality in which the head office of the proposed corporation is to be situate there exists a public necessity for the proposed loan or trust corporation. In addition, they must be satisfied with the fitness of the applicants and that public convenience and advantage will be promoted by granting the powers requested by the applicants. These requirements would be expanded to include the adequacy of the financial resources and responsibility of the major shareholders, the first directors and the senior officers. The Registrar should be responsible for the definition and publication of the specific standards and criteria. The adequacy of the financial resources and paid-up capital of a corporation would be subject to the approval of the Registrar before a new branch could be opened.

The Commissioner of Financial Institutions would be expected to explore with the Financial Advisory Committee and the industry whether it is feasible to define standards of expertise and experience with sufficient clarity to establish objectively when a corporation would be entitled to apply for fiduciary and trust powers. The Registrar would be given the statutory authority to establish such standards, if definition proves feasible. In the meantime, each corporation according to its circumstances must establish its capabilities to undertake a fiduciary and trust business to the satisfaction of the Registrar and, if necessary, the Commissioner, before the application for supplementary letters patent would be submitted to the Minister for recommendation to the Lieutenant Governor in Council.

As will be discussed in more detail later, existing corporations wishing to commence or to continue to carry on business in Ontario would be expected to satisfy comparable standards at the time of initial registration and of annual renewal, regardless of where they were incorporated.

4. ACQUISITIONS AND MERGERS

As an alternative to incorporating it has been possible for persons wishing to carry on the business of a loan or trust corporation in Ontario to acquire an existing corporation. An acquisition should be subject to substantially the same standards and requirements as incorporation. Further, a business purpose test should be introduced for all acquisitions and the public convenience and necessity test should also be satisfied, taking into account any adverse effects the acquisition might have on competition or other public interests. The financial and fitness criteria to be introduced for an incorporation should also apply to acquisitions. Similar rules and requirements should apply to proposed amalgamations and mergers of existing corporations.

The Commissioner of Financial Institutions would be expected to initiate the process whereby the criteria and procedures would be defined for the approval of acquisitions and amalgamations as part of the approval process introduced in December 1982 for transfers involving holdings of more than 10 per cent of the shares of a corporation.

5. SUBSIDIARIES

The present Loan and Trust Corporations Act and Regulations, when properly observed, contain a considerable measure of protection against the misuse of funds or the carrying on of an unauthorized activity through a subsidiary corporation. Nevertheless, some changes are considered desirable.

It is proposed that the power to incorporate or acquire mutual funds and mutual fund sales and management corporations be eliminated for the future.

At the present time, loan and trust corporations may hold a minority interest of between 20 per cent and 50 per cent of the outstanding shares of a real estate corporation, whereas such a minority investment interest is not permitted for corporations in other ancillary businesses. There may be a serious drawback in a loan or trust corporation having a significant but minority interest in a real estate corporation when it cannot control the decision-making process. Accordingly, it is proposed that the regulations be amended to make the same rules applicable to real estate corporations as apply to ancillary business corporations.

There should be a provision entitling the Registrar to require the cessation of unacceptable or unauthorized practices or activities in a subsidiary. There should also be authority to require the disposition of such a subsidiary in extreme circumstances, subject to safeguards against a forced disposition that could have serious adverse financial implications and subject to appeal to the Commissioner.

The Registrar should be given authority to define or limit unacceptable activities and functions in a subsidiary of a loan and trust corporation and to determine whether any specific subsidiary is engaging in such prohibited or unacceptable activities. Such decisions of the Registrar would be subject to appeal to the Commissioner.

The power of the Registrar to require a corporation to reduce the value of an investment in a subsidiary on its books and for borrowing purposes should be clarified. In addition, it is proposed that the manner in which subsidiaries will be accounted for on the books of the parent loan or trust corporation be a matter for determination by the Registrar.

6. AFFILIATES

The Morrison Report indicates that through concerted action by a group of persons it may be possible to circumvent some of the present restrictions and controls in the Act while creating the impression of full compliance. It is not a simple matter to prove concerted action by an apparently unrelated group although, in the result, action in concert is the only reasonable explanation.

Rather than attempt to set up complicated provisions in the Act to prevent abuses by several persons acting secretly in concert through corporations in which each of their investments is 20 per cent or less, it is proposed to reduce the maximum allowable direct or indirect investment by a loan or trust corporation in any one corporation, other than a subsidiary, to 10 per cent of the shares of each class. Authority should be given to designate any corporation in which the loan or trust corporation has an investment, or which is indebted to it, as an affiliate. Thereupon, all transactions between the loan or trust corporation and the designated affiliate would be prohibited unless the transaction is carried out at fair market value and for cash, after prior notice of each such transaction has been given by the corporation to the Registrar.

As a further deterrent and safeguard the Registrar should have the power to reduce the asset value of an investment in a designated affiliate in the borrowing base or to eliminate the investment altogether from the borrowing base. Also, the Registrar should be given the power to limit and prescribe the maximum permissible

investment in any affiliate either as a percentage of the borrowing base or in absolute dollar terms. There should be an appeal from such decisions of the Registrar to the Commissioner of Financial Institutions.

7. HOLDING CORPORATIONS

The present Loan and Trust Corporations Act does not regulate in any way the investments and other activities that may be undertaken by corporations which own or have a substantial shareholding interest in a loan or trust corporation. This subject will be mentioned later with respect to limitations on ownership of corporations. With a view to preventing some obvious abuses which recent events have disclosed, it is proposed that no transaction involving goods or services entered into between a loan or trust corporation and its parent corporation, or any other corporation holding 10 per cent or more of its shares, or any affiliate, should be permitted except for cash, or unless specifically authorized in advance by the Registrar. Further, any such transaction should be reversible if subsequent events establish that it was either improvident or that all relevant facts were not disclosed to the Registrar when his approval was obtained.

The Registrar would be expected to issue directives respecting such generally approved employer-employee arrangements as common pension, insurance and benefit plans and other permissible transactions involving parent corporations or significant shareholders of loan and trust corporations. However, transactions involving transfers of assets, fees or commissions for services, issuance of shares, loans and guarantees must be closely monitored and controlled. Further, no shares, common or preference, should be issued other than for cash except under extraordinary circumstances. In extraordinary circumstances, shares may be issued where the consideration is for independently appraised physical assets at fair market value, provided the Registrar's prior approval has been obtained.

The Registrar should be entitled to require that any transaction involving a shareholder of a loan or trust corporation be approved by the board of directors of the corporation and that full details of it be made public forthwith, if it is appropriate to do so.

An appeal to the Commissioner from most of such decisions of the Registrar is proposed.

It may prove necessary at a later date to consider introducing specific legislation to regulate the activities of holding companies following the pattern of bank holding company legislation in the United States. However, it is reasonable to determine first whether or not the other controls and measures being proposed in this paper will be sufficient.

8. FEDERAL AND EXTRA-PROVINCIAL CORPORATIONS

In 1982 more than 86 per cent of the assets of loan and trust corporations carrying on business in Ontario were owned or held by corporations incorporated outside the province. Similarly more than 86 per cent of all deposits with the industry were made with such corporations. The public in dealing with and entrusting their funds to loan and trust corporations carrying on business in this province are entitled to assume that they are all subject to the same rules and controls and are all required to conform to the same standards. It is proposed to amend the Act to ensure that all loan and trust corporations carrying on business in Ontario be subject to and abide by the same regulations and standards.

Ontario should continue to look to the incorporating jurisdiction to exercise its primary control and enforcement powers. However, when that jurisdiction does not do so, or where its standards are less strict or its administration less effective, then Ontario must be in a position and have the power to act through the Registrar to enforce its own standards and

protect its residents. For constitutional and other reasons it may be necessary to assure compliance by federal and extra-provincial corporations authorized to do business in Ontario by somewhat different statutory requirements and provisions.

9. REGISTRATION

The review process associated with initial registration to carry on business and the annual renewals thereafter provide the most effective mechanism to assure that the standards required by Ontario for all corporations are maintained. The power to impose special terms and conditions on a corporation's register, to remove or modify such terms or conditions and to expand or limit the powers it may exercise in the province, should go a long way towards preventing excesses or abuses and encouraging responsible and competent performance. It is proposed that the Act be amended to give most of these powers to the Registrar with the flexibility to exercise them selectively as the circumstances warrant, subject to appeal rights to the Commissioner.

The current practice of withholding registration of a loan or trust corporation until the Registrar receives confirmation from the Canada Deposit Insurance Corporation that the proposed registrant is a member in good standing should be formalized and made mandatory by the Act.

The registration process should be administered so that when a corporation is small with minimum capital, or where it is starting in business, then its borrowing capability should be at a minimum, its investment powers the most restrictive and its physical operations the most limited. Similarly, for corporations that have yet to prove themselves under new ownership and management, there should be provisions to enable the Registrar to reduce and limit for the time being its powers and capabilities. As its assets increase, its capital base grows and its experience and capability is gradually demonstrated with a concomitant greater protection for its depositors, the registration should be modified and expanded to permit greater borrowing multiples and wider and more flexible investment powers, but always subject to clearly defined general and specific standards and constraints.

Annually, or whenever warranted by special circumstances such as a change in control, merger or capital contribution, the status of the corporation's registry should be reassessed with a view to increasing or decreasing controls, restrictions and powers.

Where a corporation has acted contrary to the terms of its registration or any statutory or other provision to which it is subject, or where it or its depositors are in jeopardy through imprudent investments, mismatching or otherwise, the Registrar should have the power to restrict activities, reduce the borrowing base or borrowing multiple, modify investment powers and take other action appropriate to the circumstances, with corresponding modification in the registration.

A process of this kind will demand the closest working relationship between each loan and trust corporation and the Registrar. It will also require the most advanced and efficient forms of information flow to assure full, fair and prompt communication and assessment by management and the Registrar. Later in this paper the proposed changes in reporting, monitoring and information flow (some of which have already been implemented) will be discussed. This will necessarily be a changing process requiring participation by the auditors, accountants and other advisors as well as the corporations themselves and by associations and others involved in establishing financial and reporting standards.

An integral part of the registration process is to ensure that the Registrar has adequate power to require that positive and negative remedial action be taken, such as requiring an increase in capital, or restraining an improvident

investment. It is proposed that the Act be amended to give the Registrar those powers, subject to appeal to the Commissioner.

Where the primary jurisdiction of incorporation provides and effectively applies adequate controls and standards for the protection of Ontario residents, it should only be necessary for the Registrar to assure that the corporation is observing those requirements and that its registration conforms with Ontario standards.

D. LIMITATIONS ON OWNERSHIP AND TRANSFERS OF SHARES

The findings in the Morrison Report that majority shareholders, among others, had used their position and their influence to further their own interests with depositors' funds, raises the issue whether the most effective way of preventing such abuses and other conflicts of interest is to impose an absolute limit on the ownership of shares of loan and trust corporations. Such limitations now exist for banks. The federal White Paper proposed a 10 per cent limitation for federal loan and trust companies with deposit liabilities of one billion dollars or more. One problem with that approach is that there is no evidence that larger corporations are more likely to engage in such abuses than the smaller corporations. Indeed, the opposite would seem to be more likely, if any generalization is possible. None of the three Ontario loan and trust corporations or the two federal mortgage companies which were subject to recent action by the governments of Ontario and Canada would have been affected by a provision reflecting the federal proposal.

An absolute limitation on the ownership of shares in loan and trust corporations incorporated in Ontario for non-residents is now contained in the Act. This limitation of 25 per cent for all non-residents, together with a 10 per cent maximum for any one non-resident or related group, was introduced in 1970 following the federal legislation of like import for banks and federally incorporated loan and trust corporations. Both the federal and Ontario amendments were directed towards the same goal, namely the continued dominant role of Canadian financial institutions within the Canadian financial system. However, it is not the purpose of this paper to re-examine the foreign ownership question at this time.

It is recognized that since 1980, primarily for reasons of competition and reciprocity, foreign banks have been permitted to establish banking subsidiaries under a system which ensures Canadian-owned banks continue to be dominant in the Canadian banking system. The situation is somewhat different for loan and trust corporations, in that they have faced and will generally continue to face more competition than has been the case for the major Canadian banks.

When the trust company problems began to surface in 1982 there were inadequate safeguards governing the acquisition of large shareholding blocks in an active loan or trust corporation in the same way that incorporating was controlled. Accordingly, and to prevent any further automatic and unsupervised acquisitions until the whole situation was studied, legislation was passed in December 1982 restricting transfers involving more than 10 per cent of the shares to any one person or related group unless the Registrar's prior consent had been obtained. The legislation also applied to the transfer of shares of a holding corporation so that transfers of control could not occur either directly or indirectly without the Registrar's consent. One major deficiency in the legislation is that it only applies to Ontario loan and trust corporations and not to loan and trust corporations incorporated outside Ontario but carrying on business in this province. That deficiency should be corrected and the Act extended to cover all loan and trust corporations registered to do business in Ontario.

It is proposed that the criteria and standards for incorporation in Ontario should be applicable to a substantial extent to the transfers involving 10 per cent or more of the shares of a corporation according to detailed rules and procedures which should be established as part of the revision of the legislation. It would be reasonable to expect such rules and procedures to be proposed to the Minister by the Commissioner of

Financial Institutions as part of his advisory role.

To simplify the administrative process, once an approval has been given by the Registrar to the first restricted transfer then all further transfers of shares to the same purchaser should be approved automatically, unless the Registrar sends a notice of objection within a prescribed period after being advised of each proposed transfer.

It remains to be considered whether the consent procedure for transfers involving 10 per cent of the shares goes far enough or whether an absolute limit should be imposed. An examination of what has been said on the subject suggests that the potential abuses that absolute ownership restrictions are intended to counteract are basically two-fold: first, financial dominance of financial institutions in too few hands; and, second, the conflict of interest between shareholder and depositor interests and between shareholder interests and fiduciary functions. The conflicts of interest that can arise between the lending, investing and fiduciary functions irrespective of share ownership will be discussed later.

The argument that a major shareholder through control of the board and management may in certain circumstances be able to advance personal interests ahead of and in conflict with the interests of depositors and other fiduciary interests is one to which recent experience lends support. It would be fallacious to assume and unjust to suggest that a major shareholder will necessarily advance personal interests in preference to fiduciary obligations, or to assume that restricting ownership is the best or even an effective way of preventing such abuses, given the potential for disguised ownership in less than scrupulous hands. In addition, the argument loses sight of the fact that such abuses can and do occur through actions of management regardless of share ownership. The reality is that someone or some group will generally have effective practical control over a corporation at any given time, whether that is based on ownership or management. It is both simplistic and misleading to base a regulatory regime on restrictions intended to deal with only one source of control.

In recommending a restriction on the ownership of large loan and trust corporations with deposit liabilities of one billion dollars or over, the federal White Paper recognized that small and medium sized corporations need major shareholders to provide the initiative and financial support for incorporation and to provide a readily available source of capital when the corporation is in difficulties. The rationale behind the federal proposal would accordingly seem to be more against financial dominance of loan and trust corporations in too few hands rather than against conflicts of interest.

There is no convincing evidence that there is an undue financial dominance of loan and trust corporations to the public disadvantage in Ontario. Moreover, there is now doubt that the federal government intends to implement this proposal, bringing into question the fundamental premises on which the proposal is based. In fact, if it were to do so and Ontario were to follow suit, it could involve a mandatory shift of ownership of some twelve major trust companies and necessitate raising capital for that purpose in an amount in the order of two to three billion dollars. The effect of such a shift would almost certainly weaken rather than strengthen the underlying capital bases of the affected corporations. Insufficient capital, especially in these difficult and volatile times, is a continuing concern for loan and trust corporations and should also be for the public that depends upon them.

Accordingly, if an absolute limitation is to be justified, it would seem that it must be based on a conviction that there is no other effective way to avoid or minimize conflicts of interest and that the significant disadvantages of doing so must be accepted for the sake of that concern. Further, the proposals in this paper are largely directed towards a better way of dealing with

the conflict of interest problem. Nevertheless, it might be useful to examine the options which are open to the government respecting limitations on ownership:

1. No absolute limitation. This would leave the question of any increase in shareholdings involving 10 per cent or more to the discretion of the Registrar, subject to appeal to the Commissioner, based on the facts of the particular case, on the basis that we cannot answer in advance that every such increase in shareholdings is either good or bad.
2. Ten per cent. The percentage proposed in the federal White Paper for those corporations with deposit liabilities of one billion dollars or more.
3. Twenty per cent. This limit would prevent any single shareholder from having the power to block or veto a proposal in most corporations, although such a holding might still prevent an amalgamation if present voting requirements in the Act remain unamended.
4. Thirty-three per cent. This would prevent a blocking vote by a single shareholder or group only where the remaining 67 per cent is fully represented, which is an unlikely event in a public corporation.
5. Forty-nine per cent. This would prevent absolute control from being acquired but would not prevent a blocking interest. It would mean that there was always a majority interest separate and distinct from the controlling shareholder, although it would be a majority interest which might be difficult to mobilize except for blocking purposes in those cases where more than a majority vote is required.

The present disposition is not to impose by legislation any absolute percentage limit of ownership by any one person or related group. At the same time, there may be particular cases in the future that cannot be defined in advance, where a per cent limitation should apply in practice to an initial shareholding on incorporation, or to a particular transfer of shares requiring the consent of the Registrar. Also there could be situations where it was desirable to have a provision applicable to all loan and trust corporations registered to do business in Ontario whereby a person or related group holding more than a specified per cent of the shares of any class of such a corporation may be required by the Registrar to dispose of all shareholdings in excess of that per cent. This would be subject to such terms and over such period of time as may be prescribed and subject also to a right of appeal to the courts as to the adequacy of the grounds for requiring such a divestiture. The government will wish to receive comments on these questions before final decisions are made.

The Morrison Report also makes it clear that there is scope for abuse whenever those in control through shareholdings, management or otherwise, have other interests (especially in an area such as real estate) and the incentive and means to abuse their fiduciary responsibilities in relation to depositors' funds. Again it is intended that new incorporations and future transfers would not normally be approved for such persons, although it is also anticipated there would be exceptions where it is concluded that the risks of fiduciary abuse are minimal.

It should be emphasized, however, that no regulation or limitation will deter the determined and dishonest person. No outside regulation or control is as effective as the internal self-regulation of sound management and the discharge of their proper duties and responsibilities by directors, managers, lawyers, auditors and valuators. It was never intended that deposit insurance should replace or render less important deserved public confidence in these financial institutions themselves. Nor should the existence of deposit insurance be used by public depositors as an excuse to exercise less prudence in placing their funds.

The following amendments are proposed to complement the other control measures:

- The Registrar should have authority, subject always to appeal to the Commissioner, to consent to share transfers conditionally, or subject to limitations such as the reduction of borrowing capability or reduced investment or other powers until the effects of the transfer of shares have been evaluated in the operations of the corporation.
- The exemption of future transfers of shares to a particular transferee that may be given by the Registrar with the approval of the Lieutenant Governor in Council may be withdrawn at any time by the Registrar, subject to confirmation by the Lieutenant Governor in Council within a prescribed period.
- Appeals to the Lieutenant Governor in Council from the Registrar's refusal to consent to a transfer should continue to be available but only after the matter has been reviewed by the Commissioner.
- The Registrar should have the right, subject to appeal to the Commissioner, to cancel or revoke any corporation's registration wherever it was incorporated, or to impose terms, conditions or limitations upon its registration, or otherwise limit its activities in the province, if any transfers of shares of the corporation are made contrary to the provisions of the Act and without the requisite approvals.
- The Registrar should be given the necessary authority to require production of evidence of the individual beneficial ownership of shares of any loan or trust corporation registered in Ontario, or of any holding company of such a corporation, and refusal to provide information should give rise to the same powers to control and limit the corporation or to withdraw its registry as would exist for unauthorized transfers.

E. CONFLICTS OF INTEREST

The Act as presently structured and administered has not proved adequate to prevent the abuse disclosed in the Morrison Report involving the advancement of personal interests to the detriment of fiduciary responsibilities. As stated earlier, the most effective preventative is self-policing, sound and prudent business practices, and the recognition of their responsibilities by directors, managers, lawyers, auditors and valuators. A multi-faceted approach is proposed to encourage all corporations to make the necessary changes in their business practices and operations and to bring home to professionals the nature and importance of their obligations in carrying out their professional responsibilities and, in particular, the importance of keeping clearly identified the duty owed to the client corporation regardless of the shareholdings or management position of the person instructing them.

1. INTERNAL PROCEDURES

All loan and trust corporations should be required to define and establish to the satisfaction of the Registrar a review and approval procedure for all loans and investments designed to assure that levels of approval appropriate to the nature and size of the transaction are in place and operating. In addition, the process must assure that transactions are examined to determine whether any aspect involves a benefit to a shareholder, insider or others with whom the corporation has a legal or business relationship. It is proposed that transactions that involve such a benefit, if not prohibited, be approved by the board of directors, or an independent committee thereof, before they are implemented.

2. EXTERNAL ADVISORS, LAWYERS, AUDITORS AND VALUATORS

The Act should be amended to make external advisors, lawyers, auditors and valuators accountable if they knowingly participate in a breach of the conflict of interest provisions of the Act. The governing bodies of the various professional associations concerned should be invited to consider and advise the government as to the changes which they propose to make in the codes of conduct and ethics that govern their members to prevent the involvement or participation of those members in conflict of interest situations.

Auditors should be given the right to attend all meetings of the audit committee and to call such a meeting. Auditors would be expected to advise the board of directors and, failing appropriate action, the Registrar, of any breaches of the conflict of interest provisions that they are aware of and also if any significant benefits have been afforded to shareholders or insiders of the corporation without adequate consideration. They would be protected against personal liability for so doing provided they have acted in good faith.

3. NEW RESTRICTIONS AND LIMITATIONS

There should also be a number of new restrictions and limitations:

- Registered mortgage brokers and their officers, directors and employees should be ineligible to serve as directors of loan and trust corporations.
- Conflict of interest rules and prohibited transactions should apply to trust funds as well as deposit funds.
- Commercial transactions involving transfers of goods or payment for services with persons and insiders to whom the making of loans is prohibited or restricted should likewise be prohibited or restricted.
- Corporations should be prohibited from acquiring assets from or selling assets to a substantial shareholder, affiliate, or insider except with the prior approval of the Registrar.
- Corporations should be prohibited from purchasing or acquiring

management services or paying finders' fees or commissions to any corporation owned or controlled by any substantial shareholder, affiliate, or insider, or any person with whom the corporation does not in fact deal at arms length, except with the prior approval of the Registrar.

4. CIVIL CONSEQUENCES

A reviewable and voidable transaction concept should be introduced so that transactions between loan and trust corporations and a shareholder of 10 per cent or more of any class of its shares, or any affiliate of such a shareholder, may be set aside should the transaction later be found to be improvident or involve less than adequate consideration. All moneys paid or assets transferred would be recoverable by the corporation at the instance of the corporation, or on a derivative basis, by any shareholder.

5. ADDITIONAL POWERS OF THE REGISTRAR

It is proposed that the Registrar be entitled to review and assess the adequacy of internal approval processes and levels of responsibility and to require amendments or modifications thereto. The Registrar should have authority to require specific transactions to be submitted to the board of directors, or any committee thereof, and to require filing of copies of all reports of auditors and outside advisors. In addition, copies of minutes of the board and committee meetings should be filed with the Registrar on a routine basis.

F. BUSINESS AND POWERS

Corporations receiving, managing and investing funds under a fiduciary relationship must exercise the standards of a prudent lender with such funds and must also be financially conservative and responsible with their own corporate funds. It is proposed to examine a number of the borrowing, lending and deposit-taking functions in the context of those standards. It is also appropriate to examine some of the changes proposed in the federal White Paper as they might apply to loan and trust corporations operating in Ontario.

1. BORROWING, DEPOSITS AND TRUST FUNDS

Historically trust companies have accepted money from the public, including money on deposit in a chequing account, under a form of trust whereby the company commits itself or "guarantees" to repay the principal on specified dates or on demand, subject to notice, together with specified interest (which may be less than those funds actually earned when invested by the trust company). The instruments issued in respect of such funds are referred to as Guaranteed Investment Certificates (GICs) and Guaranteed Trust Certificates. On the other hand, loan corporations have borrowed money and accepted money on deposit on a debtor-creditor relationship with much the same legal consequences as money on deposit with a bank, employing debentures, demand deposits and term deposit receipts. The proposal in the federal White Paper to abandon the trust concept and, apparently, the trust relationship with all its good faith and fiduciary responsibilities, appears ill advised as it de-emphasizes the high standards of prudence and good faith required of those with fiduciary obligations. The Act should specifically provide that the same prudent standards apply to loan and trust corporations with respect to all funds borrowed or held by them. In addition, all corporations should be required to make it clear to depositors the extent to which their money is protected by the Canada Deposit Insurance Corporation insurance and the significance of the term "guaranteed" with respect to funds held by them in excess of insured limits.

Funds held in trust should be segregated and the aggregate amounts shown separately on the accounts and published balance sheets of all trust companies operating in Ontario.

2. INVESTMENTS AND LOANS

The existing provisions of the Act and Regulations governing permitted and prohibited investments and loans and the rules, standards, restrictions and limitations applicable to them, individually and collectively, are complex. It is proposed to simplify them and remove many of the dual standards for loan corporations and trust companies. In addition and as indicated earlier, provision should be made to broaden and extend investment and lending powers as capital base, borrowing multiples and financial and other resources are expanded and to give maximum investment powers to trust corporations with proven resources, management and experience.

a) Mortgages

The Act limits the amount that may be loaned by a loan or trust corporation on the security of real estate to an amount equal to three-quarters of the value of the real estate. While the term "value" is not defined it has always been interpreted conservatively by responsible corporations. In view of some of the practices which have been recently employed it is desirable to clarify accepted practices and prescribe that the value of the real estate for mortgage lending purposes should be determined by prudent lending standards based on the likely realizable value of the real property itself on the open market under circumstances that might require foreclosure or forced sale. Greater flexibility and a less strict

standard should be permitted for a limited percentage of a corporation's own funds. Third and subsequent mortgages by their nature should be limited investments for all loan and trust corporations.

In this area it is particularly important that corporations establish their own internal controls and restrictions appropriate to the general economic conditions and specific situations that arise from time to time. The Registrar would be entitled to establish general control standards and guidelines for all corporations after seeking the advice of the Commissioner and the Financial Advisory Committee. The Registrar would be required to ensure that rules respecting appraisals and appraisal standards exist for all corporations and that each corporation has a procedure in place to ensure that those rules are known and applied at all levels of authority and approval within the corporation.

Authority should be given to the Registrar to require changes in the approval process and procedures and the appraisal standards in any corporation, and the approval of specific transactions by its board of directors or a committee thereof, subject to an appeal to the Commissioner.

b) **Real Estate**

To minimize the risks inherent in investing in real estate, it is proposed that loan and trust corporations should not be permitted to own directly or indirectly real estate having an aggregate value in excess of 10 per cent of the book value of the assets of the corporation. No real estate should be purchased without competent appraisals supporting value, and periodic reappraisals should be required to establish that the percentage is not exceeded through market fluctuations. The Registrar should be entitled to require independent valuations when that is appropriate. Normally an appraisal surplus would not be permitted in the borrowing base.

Where a corporation purchases or leases real estate for its own use and as an expansion of its business, in addition to the adequacy of capital, public convenience and other tests referred to earlier, the Registrar should require confirmation that the corporation is capable of handling an expanded business without undue risks to its depositors.

It should be specifically provided that in computing percentages, real estate held directly or indirectly through a subsidiary, subject to a mortgage, must be valued and appraised on a gross basis without regard to the mortgage, rather than on a net equity basis.

3. COMMERCIAL LENDING

At present loan and trust corporations may only engage in commercial lending up to a maximum amount of 7 per cent of the book value of the assets of the corporation, under the so-called 'basket clause' in the Act. While commercial lending would assist corporations in matching short-term liabilities, it does require specialized commercial credit skills. Corporations wishing to enter this field and which can satisfy the Registrar that they have demonstrated over a period of years their capability to handle this type of lending and which have segregated the commercial lending function physically and organizationally from the investment function, should be entitled to apply to the Registrar for a special commercial lending power outside the basket up to a maximum of 15 per cent of the assets of the corporation in the aggregate and up to a maximum of 15 per cent of the borrowing base of the corporation to any one borrower or related group. This new provision would not affect other duly qualified investments or loans under the Act. Corporations engaged in commercial lending should be required to segregate their commercial lending activities from other corporate functions to prevent information obtained in confidence for one purpose from being used for another purpose. It should be emphasized that such segregation may

not provide an adequate legal defence against private claims brought against a particular corporation in a particular transaction based on deemed knowledge by a trustee or fiduciary. This is a separate issue and is one on which the government would welcome submissions from the industry, the legal profession and other interested persons.

Loan and trust corporations should not be involved in some types of activities when engaged in commercial lending, such as issuing letters of credit or guarantees. These should be specifically prohibited and the Registrar should have the authority to issue directives respecting any other activity that should more properly be left to commercial banks and therefore treated as a prohibited transaction.

4. INVESTMENT IN SHARES OF OTHER CORPORATIONS

Except as permitted for subsidiaries and except as specifically approved by the Registrar, the proposal in the federal White Paper to limit investments in shares of other corporations to a maximum of 10 per cent is a prudent one and it is proposed that the Act be amended in that way. Transitional arrangements appropriate to the circumstances would be worked out for each corporation by the Registrar to ensure that any shareholdings over the new 10 per cent limit are disposed of in an orderly way.

5. FIDUCIARY POWERS

It is proposed that no corporation be permitted to carry on in Ontario any estate, trust, agency or other similar activities or functions unless it has satisfied the Registrar that it has the commitment, organization, expertise and resources to carry out such activities competently on a long term basis. After consultation with the Financial Advisory Committee and industry associations, the Commissioner might reasonably be expected to recommend to the Minister appropriate rules and regulations governing the conduct of a fiduciary business and the standards, safeguards and other protections which are appropriate in that connection.

G. MANAGEMENT AND ORGANIZATION

1. DIRECTORS AND OFFICERS

Loan and trust corporations should be required to notify the Registrar forthwith upon the election, removal or resignation of any director giving the qualifications when elected and the reasons for the resignation, removal or replacement, such reasons to be confirmed by the director. Prior notification and approval by the Registrar would be required for the appointment of the chief executive officer and the chief financial officer of each corporation. Appeals to the Commissioner on such matters would be provided for.

2. EMPLOYEE LICENSING AND TRAINING

A system of licensing key employees to assure high standards of integrity, competence and training, on a basis similar to that in effect for insurance companies, brokers and investment businesses, has been considered. However, no steps in this direction should be contemplated until it is first determined whether an effective role can be performed by an appropriate professional or trade association in conjunction with the corporations concerned.

3. AUDIT COMMITTEE

An audit committee should be mandatory for all corporations, consisting of a majority of outside directors, that is directors who are not officers or employees of the corporation, or any affiliate. The audit committee should meet at least twice a year, be on call at the request of the auditors or any director, and available to review reports and transactions designated in the Act, regulations or by directive issued from time to time by the Registrar. The auditors should attend all meetings of the audit committee. Minutes of, and all reports submitted to, such meetings should be available to the Registrar after each meeting, if required.

4. INVESTMENT COMMITTEE

An investment committee of the board of directors, also consisting of a majority of outside directors, should be mandatory for all corporations. The role of that committee would be to assure that appropriate standards and levels of authority are in place for all loans and investments to be made by the corporation and that such standards and levels of authority are communicated to the board of directors and management regularly. Executive committees composed of a majority of outside directors could discharge the functions of such an investment committee.

5. THE BOARD OF DIRECTORS

The board should be given the ultimate responsibility of assuring that systems and procedures are in place defining the levels of authority and responsibility for all commitments and decisions of the corporation. The board would be expected to review regularly (at least quarterly) reports relating to:

(i) matching and mismatching;

(ii) matching sensitivities showing assets and liabilities, their maturities, and also interest sensitivities;

(iii) non-performing and default loans;

(iv) mortgage arrears statistics; and

(v) delinquent receivables.

Corporations engaged in commercial lending and fiduciary activities would be expected to have approved by the board of directors and in place the organizational and procedural structures for the separation and segregation of those two aspects of their business, except at the most senior levels of authority. The standards of care to be exercised by directors of loan and trust corporations should be clearly stated in the Act and those standards should not be less than those imposed by the Business Corporations Act.

H. FINANCIAL STANDARDS AND CONTROLS

1. GENERAL

The Commissioner of Financial Institutions would have the authority to recommend to the Minister for appropriate regulation the general financial standards and controls for all loan and trust corporations and, in special situations, the Commissioner could be requested by the Minister to suggest specific controls for particular corporations or classes of corporations.

2. BORROWING BASE

The assets to be included in the computation of each corporation's borrowing base should be established by regulation, taking into account the recommendations and advice of the Commissioner. Because it is such an important element in determining a corporation's financial viability and hence capacity to borrow and take deposits, it would be a matter for close monitoring and review by the Registrar. The Registrar should be given the authority to exclude assets and investments from the base and to reduce the value of any asset in the base where circumstances warrant doing so. Such Registrar's decisions would be subject to appeal to the Commissioner.

3. BORROWING MULTIPLES

As corporations grow and demonstrate competence and experience, their authorized borrowing multiple could be increased from a minimum of 10 times to a maximum of 25 times in accordance with prescribed standards and controls. The recommendations of the Commissioner would be most important in this area and in the establishment of the standards. Where circumstances change, either because of adverse experience, change of control, breach of regulations or otherwise, the multiple could be decreased to a level considered appropriate by the Registrar in the circumstances, subject to appeal to the Commissioner. It is proposed that a borrowing multiple should be a matter of public record on the corporation's annual registration and any changes in the borrowing multiple should be brought to the attention of the board of directors.

4. BORROWING COSTS AND COMMISSIONS

Recent events have shown that a loan or trust corporation can expose itself to financial risk by offering unduly generous and costly terms or commissions. Accordingly, the Registrar should have authority, subject to appeal to the Commissioner, to limit borrowing costs and commissions payable from time to time by any corporation on short or long term deposits in the light of the going terms in the marketplace and other relevant factors.

5. MATCHING

Criteria and standards for matching and specific and early action to meet and minimize mismatching are essential elements to preserve financial stability of loan and trust corporations. General standards should be established by regulation and by periodic directives of the Registrar, but each corporation should be required to set its own standards and review and monitor them regularly. The Registrar should have authority to require that specific action by taken to remedy mismatching, including reduction of borrowing multiples and imposition of specific limitations on borrowing and lending. As has already been explained, and lending should be established so that a corporation's flexibility and powers are broadened and extended, and borrowing multiples increased, as financial and human resources and expertise are demonstrated. The Registrar should be given authority to limit a company's investment and lending powers quantitatively and qualitatively. Any such action would be reviewable on appeal to the Commissioner.

I. FINANCIAL RECORDS AND REPORTS

1. REPORTING

When interest rates and other financial and business conditions change relatively quickly, a company's financial viability can also change quickly with the result that depositors and others may become at risk before any monitoring process can fully detect it. Certainly a monitoring and regulatory system based on annual financial reports and periodic inspections and audits has not proved adequate to meet current financial and business conditions. Equally, under such an approach it cannot hope to respond to changes in corporate philosophy or policy which are motivated by self-interest or to activities which are disguised through various means from scrutiny by ministry examiners. Accordingly, a major restructuring of the reporting and inspection process is proposed. As one element, the Registrar has already established on an experimental basis, with the assistance of outside advisors, a new reporting system based on monthly reports of key financial data, the recording and analysis thereof virtually immediately in a computer data bank and through sophisticated programmes and an early warning system for variations, exceptions and potential problem areas. The system has been adapted from practices and procedures found effective in another segment of the financial community. This system will require the timely reporting of uniform data in a simplified form by all loan and trust corporations. A pilot project is now being tested by twenty-five corporations with a view to introducing the full system for all Ontario corporations in January of 1984 and all other registered corporations later in that year.

The new system is designed to show infractions, exceptions, unusual variations, trends, departures from norms and other indicia of actual or potential problems on a timely basis and before problems become out of hand or incapable of early rectification. The analysis of appropriate statistics and trends by industry averages and within peer groupings will be facilitated by use of the computer data bank. In this way the Registrar, who would be responsible for monitoring all companies, can be in a position to detect and determine the cause of potential and actual difficulties and to direct specific and graduated response. Further, the system should increase the effectiveness of the self-regulatory process because boards of directors and auditors would be made aware of the potential problem areas through prompt communications and early discussions with the Registrar. An important additional benefit is that examinations, surprise audits and investigations can be directed or oriented towards specific areas on a more frequent and intense basis for those requiring it, and less frequently and more generally for those demonstrating their internal capability to deal with and resolve such problems.

No system of monitoring or inspection can prevent dishonest persons from pursuing their own ends, or necessarily detect fraudulent transactions or management misrepresentations. At the same time, effective reporting and monitoring alongside the establishment of clear standards for all involved in any aspect of the process would be a deterrent to most and a means of early detection for others.

2. INTERNAL RECORDS

It has been the Registrar's practice to allow registrants to keep their internal records according to accounting and other standards that satisfy their respective auditors and their own information and management systems. While each corporation files information with the Registrar in a generally accepted and reasonably consistent form, individual accounting practices are permitted notwithstanding the difficulties in preparing comparable statistics and other analyses. With the proposed monthly standardized

reporting systems for key financial and other data, it will be necessary to adopt greater uniformity in accounting practices and internal record-keeping. It would be an appropriate role for the Commissioner and the Financial Advisory Committee to participate in establishing such greater uniformity in collaboration with loan and trust corporations carrying on business in Ontario, their external auditors, the Canadian Institute of Chartered Accountants and other appropriate professional and industry associations.

J. ENFORCEMENT

1. GENERAL

The administration of the Act should be directed primarily to the protection of depositors' and public funds and the maintenance of public confidence in these financial institutions. While the Act should be structured to ensure maximum self-policing and the due discharge of their responsibilities by managers, directors, major shareholders and advisors, it must also contain adequate safeguards to enable remedial action to be taken or imposed effectively and expeditiously where the self-regulation process proves inadequate.

2. INVESTIGATION AND ASSESSMENT

Before a problem can be corrected its nature, cause and extent must be determined. Accordingly it is proposed to establish a specially trained and qualified group reporting directly to the Assistant Deputy Minister, the function of which would be to investigate potential and actual problems, report on their nature and severity and propose remedial or other corrective action.

3. REHABILITATION

In addition, a rehabilitation capability should be established within the division capable of monitoring and enforcing a course of action directed or imposed by the Registrar and of otherwise assisting a particular corporation to re-establish full compliance under the Act. The Registrar, subject to appeal to the Commissioner, would be given the power to modify the severity and scope of the remedial action as the circumstances warrant during the recovery and restoration process of a particular corporation. Except in extraordinary circumstances the purpose should be to achieve rehabilitation without taking physical possession and without changing the management of the corporation.

With the new and advanced reporting and monitoring systems proposed and discussed earlier, and the new controls to be put in place, it is anticipated that most corporations will work themselves out of problems with relatively minor restrictions and controls. In those rare instances when taking possession and control of the assets and possible disposition is the only realistic course, then a capability to supervise and direct such a responsibility should also be developed and in place within the financial institutions division should it be required.

4. TAKING POSSESSION AND CONTROL

The present provisions of the Act enabling the Registrar to take possession and control of the assets of a loan or trust corporation contain some deficiencies. It is proposed to rectify as many of these deficiencies as are within the provincial authority and to seek the cooperation of the federal government and other provinces in rectifying the others. In extreme circumstances, as in the recent past, the Registrar can be directed by order-in-council to take possession and control of the assets of a provincial corporation. Thereafter the Registrar is obliged to conduct its business and take such steps as are necessary towards its rehabilitation. If rehabilitation and restoration of the corporation to full compliance with the Act is achieved, the Registrar is required on the order of the Minister to return possession and control of the assets to the corporation and its shareholders with a view to its business continuing normally. The fragility of public confidence is such that this is an unlikely event. In the alternative, if rehabilitation is not possible for any reason, the corporation can be wound up under the provincial or federal Winding-up Acts depending upon its solvency or insolvency, or the assets can be turned back and the winding up left to the shareholders. It is unlikely that there will be assets for the corporation or its shareholders where there are significant deficiencies, particularly where the CDIC has been obliged to meet insurance claims and has taken security on the assets in respect thereof.

There are at present no corresponding provisions for the Registrar to take possession and control of the Ontario assets of a federal or extra-provincial trust corporation. It is proposed, subject to appropriate safeguards, that this be rectified, although in practice the incorporating jurisdiction would be expected to take primary responsibility in that regard. There is also no specific authority to sell the undertaking with all or part of the assets of any corporation. It is proposed that there should be, subject to approval by the courts as outlined in the section on Hearings and Appeals. This would be in addition to the inherent power of the legislature to pass specific legislation applicable to a particular corporation, as occurred earlier in 1983 with the enactment of the Crown Trust Act.

There is also no authority to substitute trustees or fiduciaries without the consent of interested parties. This limits the ability of the Registrar to deal with the fiduciary business. It is proposed to introduce an expeditious procedure to appoint interim and substitute trustees on application by the Registrar to the Supreme Court, but at all times subject to court approval.

There is no authority under the Act to deal with insolvent loan and trust corporations because insolvency is a federal matter. Further, the existing Bankruptcy Act probably does not apply to insolvent loan or trust corporations, so that recourse in such cases must be had to less flexible winding-up legislation. This will change under the proposed new federal Bankruptcy Act when it is passed.

Preservation of the business of a loan or trust corporation and its goodwill may require immediate action by the Registrar to take possession and control of the assets. While the amendment passed in December 1982 permits such taking of possession and control without a hearing, that necessarily should occur only in extraordinary circumstances. On the other hand the normal hearing process in the courts could seriously impair the very business and assets sought to be preserved. A revised hearing process is proposed to meet this problem applicable to all but the extraordinary cases. This is outlined in the section on Hearings and Appeals.

Action is being initiated with the other provinces and the federal government with a view to uniform legislation so that full authority by the appropriate regulatory authorities to possess and deal with assets in different provinces will exist regardless of where a particular corporation is incorporated.

5. PENALTIES

The following additional penalties and liability provisions are proposed:

A. Any director or officer of a loan or trust corporation registered in Ontario would be subject to a penalty of up to $100,000 for failure to disclose a personal conflict of interest in any transaction involving that corporation. Further, the transaction would be capable of being set aside and the director or officer would be personally liable to account for all money received and for any loss suffered by the beneficiaries of any trust or by any other person in a fiduciary relationship.

B. Any nominees or other persons who knowingly allow their names to be used on behalf of a person having a beneficial interest for the purpose of disguising or keeping secret the involvement of such person for reasons related to compliance with provisions of the Act would be subject to a penalty of up to $100,000.

6. EXCHANGE OF INFORMATION

Provision should be made for the exchange of information between the Registrar and persons having similar or related authority in other jurisdictions and with law enforcement agencies anywhere, without breaching confidentiality laws in so doing.

K. HEARINGS AND APPEALS

It is proposed that, with one exception, no enforcement action should be taken nor should any limitation or condition be imposed upon a corporation's registration or any other remedial action be taken or imposed until the corporation has had the opportunity to be heard with counsel before the Registrar, subject to an appeal to the Commissioner of Financial Institutions on substantive matters affecting the business of the corporation. The exception is an order-in-council, made pursuant to the amendments passed in December 1982, directing the Registrar to take possession and control of the assets of a corporation without a hearing. That provision should remain substantially intact to enable immediate action when depositors or the public are at serious risk, and it should be extended to cover the Ontario assets and business of all loan and trust corporations carrying on business in Ontario regardless of their place of incorporation.

An expedited hearing and appeal procedure is proposed for normal cases involving the following elements:

1. Any special report or other appropriate summary of the facts or issues should be sent to the corporation concerned by the Registrar, who would normally invite informal discussions of its content.

2. The Registrar would have the following options respecting the matter at issue.

   a. hold a formal hearing, at which the corporation may be represented by counsel, to determine what action should be taken, if any, to protect depositors and the public in light of the contents of the report or other document;

   b. issue a directive requiring that specified action be taken by the corporation on or before a specific date unless the corporation shall show cause in a hearing before such date why such action should not be taken; or

   c. issue a directive requiring immediate specific action by the corporation and designating a date for a hearing to determine the terms and conditions under which the directive might be modified or withdrawn and to determine what further action, if any, might be appropriate.

3. Directives and decisions of the Registrar would be subject to appeal to the courts on errors of fact or law in the normal course. Pending the outcome of the appeal, the corporation should comply with directives or decisions of the Registrar unless the corporation can satisfy the Court that non-compliance with the directive or decision will not imperil or otherwise adversely affect the depositors or the public interest.

4. Where the Registrar has taken possession and control of the assets of any corporation and is satisfied that the rehabilitation of the corporation is not possible within a reasonable period or that it is otherwise not in the best interests of the depositors to attempt to do so, the Registrar would be entitled to apply to the court for an order:

   (i) authorizing some other person to carry on the business of the corporation on such terms and conditions as the court thinks fit;

   (ii) authorizing and directing the sale of the assets of the corporation in whole or in part, subject to the direction of the court;

   (iii) appointing interim or permanent substitute trustees in respect of all or any part of the fiduciary or trust business of the corporation; and

   (iv) authorizing or directing such other action as the court thinks appropriate and in the best interest of the depositors, the creditors and the public.

The present Act contains a number of matters which are subject to the discretion, or are finally determined by, the Lieutenant Governor in Council. These include the issuance of letters patent, supplementary letters patent, amalgamations, increases in powers and borrowing multiples, and certain appeals. In introducing appeals to the Commissioner of Financial Institutions from decisions of the Registrar, it is not proposed that there be any modification of the Act affecting the final authority of the Lieutenant Governor in Council.

LOAN CORPORATIONS REGISTERED IN ONTARIO

Provincial Ontario Corporations:

The Canborough Corporation
Home Savings & Loan Corporation
Landmark Savings and Loan Association
London Loan Limited
The Municipal Savings & Loan Corporation
Nipissing Mortgage Corporation
Shoppers Mortgage and Loan Corporation
Termguard Savings & Loan Company

Extra-Provincial Corporations:

Quebec

Credit Foncier
The Royal Trust Company Mortgage Corporation

Federal Corporations:

Bank of America Canada Mortgage Corporation
Bank of Montreal Mortgage Corporation
Canada Permanent Mortgage Corporation
Canada Trustco Mortgage Company
CBC Mortgage Investment Corporation
Central and Eastern Mortgage Corporation
CIBC Mortgage Corporation
Citibank Canada Mortgage Corporation
Continental Bank Mortgage Corporation
Equitrust Mortgage and Savings Company
Fedco Mortgage Investment Company
Fidmor Mortgage Investors Corporation
First City Mortgage
Greymac Mortgage Corporation
Morguard Home Mortgage Investment Corporation
Morguard Mortgage Investment Company of Canada
Nova Scotia Savings & Loan Company
Procan Mortgage Corporation
Royal Bank Mortgage Corporation
Royal Trustco Mortgage Company
Scotia Mortgage Corporation
Seaway Mortgage Corporation
Seel Mortgage Investment Corporation
Standard Loan Company
TD Mortgage Corporation
Victoria and Grey Mortgage Corporation

TRUST COMPANIES REGISTERED IN ONTARIO

Provincial Ontario Corporations:

Cabot Trust Company
Community Trust Company Ltd.
Counsel Trust Company
Crown Trust Company
District Trust Company
The Dominion Trust Company
The Effort Trust Company
Executive Trust Company
Family Trust Corporation
Financial Trust Corporation
Greymac Trust Company
Huronia Trust Company
London Trust & Savings Corporation
Monarch Trust Company
The Municipal Trust Company
National Trust Company Limited
Seaway Trust Company
Security Trust Company
Vanguard Trust of Canada Limited
Victoria and Grey Trust Company

Extra-Provincial Corporations:

Alberta

First City Trust Company

Manitoba

Inland Trust and Savings Corporation Limited
Investors Group Trust Co. Ltd.

Quebec

The Bankers' Trust Company
Credit Foncier Trust Company
General Trust of Canada
General Trust Inc.
Guardian Trust Company
Montreal Trust Company
Quebec Trust
The Royal Trust Company
Savings and Investment Trust

Federal Corporations:

Bayshore Trust Company
Canada Permanent Trust Company
Central Trust Company
Continental Trust Company
Co-operative Trust Company of Canada
Eaton Bay Trust Company
The Equitable Trust Company
The Fidelity Trust Company
Guaranty Trust Company of Canada
Income Trust Company
The Interior Trust Company
The International Trust Company
Marcil Trust Company
The Merchant Trust Company
Montreal Trust Company of Canada
Morgan Trust Company of Canada
Morguard Trust Company
North Canadian Trust Company
The Premier Trust Company
The Regional Trust Company
Royal Trust Corporation of Canada
Standard Trust Company
Sterling Trust Corporation
Western Capital Trust Company

POOR

QUALITY

ORIGINAL